



GOOD ECONOMICS – BAD LAW: A 40-YEAR NATURAL EXPERIMENT

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ABSTRACT: Forty years have passed since James Buchanan published his article “Good Economics – Bad Law.” In Buchanan’s piece, he engages in a thought experiment regarding how the law and economics field will develop. Given that all of the assumptions Buchanan makes in his thought experiment have turned out to be a reality, I investigate how Buchanan’s predictions compare to the actual development of law and economics. I argue that Buchanan’s predictions have become a reality and explain how equilibrium theorizing gave rise to this reality. Specifically, Chicago style neo-classical economics can be a valuable tool for analyzing rules within a given institutional environment, but is unable to aid discussions over the meta-rules that define the environment under which exchange takes place. Because of his accurate predictions,

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Buchanan's expanded law and economics paradigm – Constitutional Political Economy – warrants our renewed attention.

INTRODUCTION

Forty years ago, in 1974, James Buchanan wrote "Good Economics – Bad Law."¹ In his article, Buchanan reviews Richard Posner's textbook, *Economic Analysis of Law*,² in an unorthodox fashion. Buchanan creates a thought experiment, predicting that diligent students who rigorously apply Posner's teachings will be left with a cognitive dissonance. The thought experiment serves to illustrate how, according to Buchanan, Posner's tool kit proves fruitful for making decisions of a "legislative" nature but relatively unfruitful for decisions involving collective action or constitutional design.³

Buchanan's argument can only be fully understood by accounting for the context in which he is writing. In the 1960's at the University of Chicago, the law and economics movement shifted into a higher gear, marked both by the founding of the *Journal of Law and Economics* and a distinct shift in emphasis. Articles by Becker, Coase, Demsetz, Landes, and Manne, pioneered using economic analysis of law to understand laws beyond those that regulated financial interactions.⁴ Rowley observes that the "distinctive feature [of Chicago style law and economics] is the application of market economics to legal institutions, rules, and procedures which in certain areas (notably in tort and in crime) are not conventionally seen to influence market behavior, but which

¹ James M. Buchanan, *Good Economics. Bad Law*, 60 VA. L. REV. 483 (1974).

² RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (8th ed. 2011).

³ See Buchanan, *supra* note 1, at 491.

⁴ Ejan Mackaay, *History of Law and Economics*, in *ENCYCLOPEDIA OF LAW AND ECONOMICS* 65, 76 (Boudewijn Bouckaert & Gerrit De Gheest eds., 1999), available at <http://encyclo.findlaw.com/0200book.pdf> (internal citations omitted).

indeed are defined in terms of market failure".⁵ Mackaay describes three events that lead the Chicago approach to dominate law and economics:

Three events signal a change in the movement in the direction of capturing the hearts and imagination of lawyers: the foundation, in 1972, of the *Journal of Legal Studies*; the first publication, of Posner's introduction to the economic analysis of law, both at the Law School of the University of Chicago; the organization, from 1971 on, of Henry Manne's already mentioned Economics Institutes for Law Professors, short intensive seminars in economics for lawyers, be they judges, practitioners or law teachers. Together, one might say, they mark the entrance of law and economics into law schools in the United States.⁶

In order to further illustrate the enthusiasm that the economics profession had for the Chicago approach to law and economics, Mackaay also points out that Hayek's *Law Legislation and Liberty* series, which does not utilize the Posnerian paradigm, has been largely unnoticed to law and economics scholars.⁷ Even though the first three volumes of *Law Legislation and Liberty* were published in 1973,⁸ 1976,⁹ and 1979,¹⁰ and Hayek won the Nobel Prize in Economics in 1974, Mackaay argues that Hayek's works were overshadowed by Posner's textbook published in 1972.¹¹

⁵ Charles Rowley, *Public Choice and the Economic Analysis of Law*, in *LAW AND ECONOMICS* 125 (Nicholas Mercuro ed., 1989).

⁶ Mackaay, *supra* note 4.

⁷ *Id.* at 75.

⁸ 1 F. A. HAYEK, *LAW, LEGISLATION AND LIBERTY: RULES AND ORDER* (1978).

⁹ 2 F. A. HAYEK, *LAW, LEGISLATION AND LIBERTY: THE MIRAGE OF SOCIAL JUSTICE* (1978).

¹⁰ 3 F. A. HAYEK, *LAW, LEGISLATION AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE* (1981).

¹¹ Mackaay, *supra* note 4, at 75.

In 1974, Buchanan reviews Posner's book at a time when the book and its overarching research program are racing towards their high point of influence. As a critic of the approach in that book, Buchanan is certainly in the minority at the time he publishes "Good Economics – Bad Law."

I. GOOD ECONOMICS – BAD LAW

Buchanan asks his readers to assume that Posner's textbook is widely adopted as standard material for first-year law students and that the students are sufficiently well-motivated and intelligent to retain Posner's economics teachings when they find themselves in positions of decision-making power and influence later in life, as lawyers, judges, or scholars.¹²

Once these law students find themselves in a situation that warrants applying Posner's teachings, Buchanan argues that they will find themselves with a cognitive dissonance.¹³ This is because, according to Buchanan, Posner does not fully appreciate the severability of positive economic analysis and the efficiency norm.¹⁴ Posner's inability to separate these two concepts critically handicaps his law and economics. For example, when discussing the economics of rape and robbery, Posner must claim that freely negotiated exchanges between parties could emerge to maximize efficiency.¹⁵ Buchanan writes that this 'hard-nosed' price theory leads some of Posner's arguments to approach "absurdity" because efficiency is not always the appropriate basis for making legal decisions.¹⁶

If, however, broader *philosophical* criteria are introduced, the law, itself must be evaluated and good economics applied within a

¹² Buchanan, *supra* note 1, at 485

¹³ *Id.* at 486.

¹⁴ *Id.* at 485.

¹⁵ *Id.*

¹⁶ *Id.*

bad or misguided conception of legal process need not promote the structural, procedural changes that may be urgently required. It is in this respect that Posner's work fails my test.¹⁷

Posner's "hard-nosed" price theory utilizes efficiency as both an *instrumental* value and a *final* value in legal decisions. In essence, Buchanan argues that efficiency may function well as an instrumental value that is congruent with many types of social order, but becomes problematic when used as a final value against which all law must ultimately be evaluated.¹⁸ Thus, Buchanan sees Posner's examples regarding rape and robbery as approaching absurdity because the very fact that citizens must bring criminal charges against each other for such crimes indicates that social order departs from maximized efficiency, and "for this reason, suggests the necessity of some replacement of the maximum value criterion for legal resolution."¹⁹

However, Posner's failure to distinguish between using efficiency as an instrumental and final value does not render his project, or his method, useless. Buchanan argues that the efficiency norm is effective as an instrumental goal.²⁰ For example, under the Posnerian paradigm, "If the law fails to allocate responsibilities between parties in such a way as to maximize value, the parties will, by an additional and not costless transaction, nullify the legal allocation."²¹ Buchanan points out that this does capture a fundamental economics principle: when mutual gains from trade exist, parties tend find ways to realize those gains; by internalizing this lesson, lawmakers and lawyers are in a much better position to use law to help facilitate peaceful interaction amongst citizens.²²

¹⁷ *Id.* at 484.

¹⁸ *Id.*

¹⁹ *Id.* at 485.

²⁰ *Id.*

²¹ POSNER, *supra* note 2, at 99; Buchanan, *supra* note 1, at 485.

²² Buchanan, *supra* note 1, at 486.

Although Posnerian law and economics is far from useless, Buchanan argues that truly ‘good economics’ would be based on an understanding of the market as a mechanism for maintaining social order “which is not that of insuring efficiency, or maximizing value as measured in market-determined prices.”²³ In order to illustrate the implications and suggest an alternative framework for treating efficiency as the ultimate, or final, end of law, Buchanan draws on Bruno Leoni’s distinction between law and legislation.²⁴

Leoni draws an important distinction between ‘law’ and ‘legislation.’ Legislation is made, planned, and rationally constructed within the bounds of a constitutional framework that governs both the contents of that legislation and the process by which it is made.²⁵ Legislation also has distinct social goals. Contrarily, according to Leoni, law is not made. Law is the product of independent judges working, in a relatively uncoordinated manner, on an open-ended and never ending search for ‘law,’ which is the emergent product of the judicial *process*.

Using efficiency as an instrumental value will be very fruitful for legislative purposes, according to Buchanan, but unhelpful for jurors and judicial decision makers charged with determining what ‘law’ (as Leoni describes it) will be.²⁶ When it comes to legal decisions that are not legislative, judges are often guided by criteria other than efficiency considerations, and according to Buchanan, rightly so. Judges may be guided by precedent, custom, tradition or other intra-legal criteria dictated by the institutional setting a judge confronts.²⁷

According to Buchanan, a constitutional democracy has three general parts: 1) constitutional rules; 2) rules that adjudicate

²³ *Id.*

²⁴ *Id.* at 488-89.

²⁵ LEONI BRUNO, FREEDOM AND THE LAW (1961).

²⁶ *Id.* at 27.

²⁷ *Id.* at 489-90.

conflict; and 3) rules that involve collective decision-making of an ordinary legislative variety.²⁸ While Posner's paradigm can be fruitful for analyzing legislative questions regarding rules that adjudicate conflict within a broader institutional context, these are not the only types of questions that lawyers and legal scholars face. Constitutional questions, understood as questions about meta-rules or the rules under which legislative activity can take place, as well as rules that involve collective decision-making, cannot be meaningfully solved by rigorously applying an efficiency or wealth-maximizing standard because such standards are derived "extra-legally."²⁹ The Posnerian economist is (1) only equipped to deal with legislation (2) is dumfounded when confronted with constitutional questions and (3) is potentially dangerous when the distinction between these two types of question is unclear as it is with rules that involve collective action.

In the subsequent sections of the paper, I will argue that the assumptions Buchanan asks his reader to make in his mental thought experiment have become a reality in law and economics; thus the past 40 years of evolution in the law and economics field provide a natural experiment for Buchanan's thesis. This gives us an opportunity to evaluate whether Buchanan's argument in "Good Economics—Bad Law" is accurate. I argue that Buchanan's predictions in his thought experiment have become a reality as evidenced by the current divide amongst law and economics scholars and the areas of law where law and economics has been most influential. In light of Buchanan's accurate assessment of the law and economics movement, I ask what economists can learn from Buchanan, and I argue that neoclassical equilibrium theorizing, which underlies Posner's law and economics, is only

²⁸ *Id.* at 491.

²⁹ *Id.* at 491-92.

useful in a given institutional environment; it is not useful for discussions over the meta-rules of the game.

II. A NATURAL EXPERIMENT

Since Buchanan's 1974 article, law and economics has developed characteristics almost identical to those Buchanan poses as hypothetical in his thought experiment. Firstly, Buchanan asks us to assume that Posner's textbook becomes a standard text in the emerging law and economics field. Not only has the law and economics method permeated, in various degrees, the curriculum at most major law schools in the United States, but also Posner's *Economic Analysis of Law* became, and remains, the leading introductory textbook on the subject; the book is currently in its ninth edition. Furthermore, since 1972, a variety of journals dedicated to studying law and economics have formed, including *The Journal of Legal Studies*, *American Law and Economics Review*, *The European Journal of Law and Economics*, and the *Supreme Court Economic Review* to name a few.

Buchanan also assumes that the students are diligent and intelligent enough to retain Posner's teachings once they find themselves in positions of decision-making power later in their careers. We can easily observe this group of people by watching legal scholars in the law and economics literature who arise in the years after 1972 (when Posner published the first edition of *Economic Analysis of Law*).

Writing on the history of the law and economics movement, Mackaay distinguishes between four time periods of importance since the 're-birth' of modern law and economics in the 1950's.³⁰ According to Mackaay, from 1958-1973 the Chicago law and economics paradigm is proposed; then right after Posner publishes his textbook, from 1973-1980 the paradigm is accepted by the

³⁰ Mackaay, *supra* note 4, at 71-74.

mainstream.³¹ During 1976 to 1983 the paradigm is “questioned” and from 1983 onwards, Mackaay describes the Chicago law and economics paradigm as “shaken.”³²

Of particular interest to our purpose is 1976-1983 period. Veljanovski describes this period as one “of maturation and consolidation” for the law and economics movement.³³ In 1976, Schmid makes the first major critique of the Chicago law and economics paradigm, arguing that since there is a cost minimizing (efficiency maximizing) allocation of resources under any distribution of property rights,³⁴ cost minimization itself, and thus the efficiency based logic put forth by Posner, cannot be both the basis for both rights and the distribution of resources. Neil Duxbury echoes this critique.³⁵

The circularity in Posner’s efficiency thesis not only undermines his law and economics paradigm but also undermines one of his most notable conclusions: the efficiency of common law. According to Mackaay,³⁶ no one has been able to articulate a theory that has gained general acceptance for the emergence of an efficient common law.³⁷ This is most likely because the efficiency thesis is circular and non-falsifiable.

Other scholars argue that the efficiency thesis central to the Chicago law and economics paradigm, exemplified in Posner’s textbook, is ahistorical. Veljanovski challenges the efficiency thesis

³¹ *Id.* at 71-80.

³² *Id.*

³³ CENTO, G. VELJANOVSKI, *THE ECONOMICS OF LAW: AN INTRODUCTORY TEXT* 26 (1990), construed in Mackaay, *supra* note 4, at 80.

³⁴ A. Allan Schmid, *The Economics of Property Rights: A Review Article*, 10 J. ECON. ISSUES 159-68 (1976).

³⁵ NEIL DUXBURY, *PATTERNS OF AMERICAN JURISPRUDENCE* 386-93 (1995).

³⁶ Mackaay, *supra* note 4, at 92-94.

³⁷ For a full list of citations of articles attempting to articulate a theory for the efficiency of common law within the Chicago law and economics paradigm, see Mackaay, *supra* note 4.

to explain changes in the law over time.³⁸ Veljanovski argues that the efficiency thesis should imply that legal systems converge over time and should also preclude legal changes from an efficient allocation to a less efficient allocation, but this is not what we see throughout history.³⁹

In addition to criticizing the efficiency thesis itself, scholars also engage in a rigorous application of efficiency to legal questions, which inspires further critiques. Trebilock argues that the incentive and risk spreading logic in Posner does not lead to unambiguous policy conclusions following Posner's welfare maximization criteria.⁴⁰ Specifically, if courts are committed to spreading accident costs as thinly as possible, Trebilock suggests that the state should be liable for all accident costs.⁴¹ While Posner may respond that transaction costs prohibit his paradigm from producing these strange conclusions, Trebilock's arguments do point out the operational problems of using Posner's paradigm.

Finally, the efficiency paradigm proposed in Posner requires a judge to be able to access objective empirical information. Motivated by the Austrian proposition that 'facts' in the social sciences are determined by actors' thoughts and beliefs, Mario Rizzo critiques Posner. Rizzo points out that the Learned Hand test for negligence requires interpersonal utility comparisons and the absence of sheer ignorance,⁴² and that 'efficiency' and subjective

³⁸ Veljanovski, *supra* note 33, at 97.

³⁹ *Id.* (The rise and development of Public Choice has offered economists many tools to explain moves to less efficient laws).

⁴⁰ Michael J. Trebilcock, *The Future of Tort Law: Mapping the Contours of the Debate*, 15 CAN. BUS. L.J. 471 (1989); Michael J. Trebilcock, *The Social Insurance-Deterrence Dilemma of Modern North American Tort Law: A Canadian Perspective on the Liability Insurance Crisis*, 24 SAN DIEGO L. REV. 929 (1987).

⁴¹ *Id.*

⁴² Mario J. Rizzo, *Law Amid Flux: The Economics of Negligence and Strict Liability in Tort*, 9 J. LEGAL STUD. 291 (1980).

value are fundamentally at odds because of how each actor assesses and values his choices.⁴³

Several modern day law and economics scholars verify that Mackaay's account of history is indeed still accurate today. A 2011 article published by the University of Chicago alumni magazine asked ten law and economics scholars at the University of Chicago Law School to submit essays on the future of law and economics.⁴⁴ Every single essay takes time to point out the increasing divide between economists and lawyers, suggesting that the two groups see little ground for intellectual exchange in either analytical methods or research results. While different scholars assign differing normative significances to this view and offer different hypotheses on why this divide occurred, all agree that the increasingly technical field of law and economics is disconnected from law scholars.

Of particular note is Eric Posner's essay on the future of law and economics.⁴⁵ E. Posner categorizes the law and economics profession as divided between two sub-disciplines, those engaged in "economics law and economics" (ELE) and "law law and economics" (LLE).⁴⁶ ELE is mathematical and descriptive; thus, it is the group where economists dominate.⁴⁷ LLE is verbal, philosophical, often normative, and typically done by legal scholars who do not have PhDs in economics, according to E. Posner.⁴⁸ To make his distinction clear, E. Posner gives an example of how these groups differ in their methodology:

⁴³ Mario J. Rizzo, *The Mirage of Efficiency*, 8 HOFSTRA L. REV. 641 (1980), available at <http://scholarlycommons.law.hofstra.edu/hlr/vol8/iss3/7>.

⁴⁴ Douglas Baird et al., *The Future of Law and Economics: Essays by Ten Law School Scholars*, 58 L. SCH. REC. 18 (2011), available at <http://www.law.uchicago.edu/alumni/magazine/fall11/lawandecon-future>.

⁴⁵ *Id.* at 21-23.

⁴⁶ *Id.* at 21.

⁴⁷ *Id.*

⁴⁸ *Id.*

This divergence is already evident. To take one of many examples, economists who study contracts are doing something different from law professors who study contract law. Economists take contract law as given and analyze how rational agents would design optimal contracts. Lawyers focus on how to design optimal contract law, not contracts. The two groups are aware of each other, but they exert less and less influence over each other.⁴⁹

In the same collection of essays, Saul Levmore writes about the implications of this methodological divide and predicts that if methodology is dominated by empirical work, the primary audience for law and economics will be regulators as opposed to judges and practicing lawyers.⁵⁰ Because of this difference in methodology, the economic approach to law has, in E. Posner's estimation, dominated contract law, commercial law, bankruptcy law, and securities law.⁵¹ On the contrary, economics has had significantly less influence on public law, constitutional law, immigration law, and international law, areas of legal scholarship where a more philosophical and normative approach dominates.⁵²

Buchanan's 1974 article anticipates each of these developments in the evolution of law and economics. By criticizing Posner's text for not distinguishing between efficiency as an instrumental value and efficiency as a final value, Buchanan's critique anticipates Schmid and Veljanovski.⁵³ Buchanan's discussion on the absurd conclusions of Posner's 'hard-nosed' price theory leads him to anticipate Trebillock's conclusion about the difficulty in operationalizing the efficiency thesis.⁵⁴ Furthermore, Buchanan's

⁴⁹ *Id.* at 22.

⁵⁰ *Id.* at 23-24.

⁵¹ *Id.* at 22.

⁵² *Id.*

⁵³ See Schmid, *supra* note 34; Veljanovski, *supra* note 33.

⁵⁴ Trebillock, *supra* note 40.

discussion about extra-legal norms and ideas anticipates critiques from Rizzo.⁵⁵

Buchanan's mental experiment also anticipates E. Posner's and Levmore's comments about the law and economics profession. Buchanan theorizes that the Posnerian paradigm would be a useful tool for understanding legislation;⁵⁶ this is exactly the trend Levmore describes.⁵⁷ Furthermore, E. Posner's comments on the divide in law and economics also vindicate Posner. E. Posner argues that legislative laws are laws made within a broader institutional framework;⁵⁸ these are the laws that Buchanan predicts Posner's method will prove most fruitful to analyzing.⁵⁹ In fact, if we examine the list detailing the types of law where economics has had the most influence, the reader can observe that every single one of those are types of law that are of a 'legislative' nature. In other words, they are laws that operate within a defined constitutional context. Consequently, those areas of law, which E. Posner claims have been impacted minimally by economic analysis, are also the areas of the law that involve discussions over the rules of the game themselves; the exact type of laws that Buchanan claims Posner's analysis does not lend itself to that have been dominated by more philosophical approaches.

III. EQUILIBRIUM THEORIZING IN LAW AND ECONOMICS

Richard Posner is clearly writing within the Chicago School Economics tradition. His approach is neoclassical in nature: valid assumptions are sacrificed for predictive power, and the world is compared against an equilibrium ideal. Posner is explicit about this method. In fact, on the very first page of his book, *The Economics of*

⁵⁵ Rizzo, *supra* note 42; Rizzo, *supra* note 43.

⁵⁶ Buchanan, *supra* note 1, at 486.

⁵⁷ *Id.* at 59.

⁵⁸ *Id.*

⁵⁹ *Id.* at 486.

Justice, Posner states that economics is, in essence, “the assumption that people are rational maximizers of their satisfactions.”⁶⁰ Neoclassical economic models assume buyers and sellers have perfect knowledge of their utility functions and constraints. Thus, maximizing utility is only a question of coordination, which the market helps them achieve. Given how Posner conceptualizes economics and the economic problem, his law and economics is also constructed around the equilibrium ideal. Zywicki and Sanders describe how Posner sees law as a set of purposive rules.⁶¹ For example, the role of the judge is to make decisions based on efficiency criteria.⁶² Law is, therefore, a conscious order, and judges make a conscious effort to equilibrate coordination problems. Posner clearly says: “the law is not a thing [judges] discover; it is the name of their activity.”⁶³

Given this conception of economics and the economic problem, most neoclassical economists engage in ‘equilibrium theorizing.’⁶⁴ In equilibrium theorizing, markets tend toward an idealized equilibrium and are evaluated based on how close they come to equilibrium.⁶⁵ Equilibrium is of particular importance to economists working on this paradigm, since achieving equilibrium in one market is a pre-requisite for achieving general equilibrium, which in turn is a prerequisite for satisfying the first fundamental welfare theorem of economics: that a Walrasian general equilibrium is Pareto Efficient.⁶⁶ Efficiency is therefore the metric with which

⁶⁰ RICHARD A. POSNER, *THE ECONOMICS OF JUSTICE* (1983).

⁶¹ Todd J. Zywicki & Anthony B. Sanders, *Posner, Hayek, and the Economic Analysis of Law*, 93 IOWA L. REV. 559 (2007).

⁶² *Id.*

⁶³ RICHARD A. POSNER, *THE PROBLEMS OF JURISPRUDENCE* 225 (1990).

⁶⁴ *Id.* at 83.

⁶⁵ *Id.*

⁶⁶ See generally, EDGAR K. BROWNING & MARK A. ZUPAN, *General Equilibrium Analysis and Economic Efficiency*, in MICROECONOMICS: THEORY AND APPLICATIONS (2015).

neoclassical economists evaluate the degree to which a market is in equilibrium.

When used as a tool for evaluating rules within a constitutional context, the Posnerian method, characterized by maximizing efficiency, will 'work' relatively well. Within a constitutional context, economic actors tend to exploit opportunities for mutual benefit: laws that prohibit this can easily be judged as inefficient, and laws that facilitate exchange can easily be judged as efficient.

Even though, the neoclassical perfect competition model makes assumptions that will never be true regarding the knowledge of economic agents, this is of little consequence for using the neoclassical paradigm to analyze rules in a given institutional environment. Repeated interactions between buyers and sellers in the market place create prices, or knowledge surrogates of relative scarcities that economize on communicating the tacit and local knowledge necessary for economic calculation.⁶⁷ Typically, the exchanges that take place in a given institutional context are very frequent (high 'n' number of exchanges). Because such exchanges tend to be more frequent, more knowledge conducive to economic calculation is generated and the market approaches what the neoclassical perfect competition model would predict.

Where exchange is frequent, the market is able to generate the knowledge that buyers and sellers need in order to engage in economic calculation; reality approaches neoclassical perfect competition; and the epistemic demands on judges are low. If knowledge about how economic agents are behaving in a market is relatively abundant because trades are so frequent, then an efficiency maximizing judge can more easily envision an equilibrium, based on his own observations and experience, and help resolve a dispute over conflicting claims or help trading parties move closer to that equilibrium.

⁶⁷ F. A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945).

For example, a judge can use market prices to estimate the costs of particular actions and then use those costs in a game theoretic model to determine an ‘optimal’ contract rule. With enough information, questions in contract law, commercial law, bankruptcy law, and securities law can easily be reduced to engineering questions. Given an engineering problem, if a judge calculates correctly, he should be able to maximize efficiency since the problem is ultimately one of applied mathematics.

Since in a market with a high number of trades, the equilibrating tendencies of a market do not deviate strongly from the perfectly competitive model, judges can make fairly accurate efficiency claims about law without being concerned about not having access to the complete spectrum of necessary knowledge in order to make such a claim.

However, even though situations with a large number of exchanges typically approximate a competitive market, which puts low epistemic demands on an efficiency maximizing judges, the epistemic demands are not zero. Using the neoclassical model as an approximation is not of zero consequence. Zywicki explains how Posnerian inspired economic analysis failed in light of tradition in strictly liability law.⁶⁸

Unlike when making efficiency claims about laws that adjudicate conflicting claims within a given set of rights and rules (institutional context), the neoclassical method will not be useful for discussions over the rules themselves. Exchanges, or interactions, between economic actors over the meta-rules (constitutional rules) within which this exchange will take place, don’t involve a high amount of repeated interactions (they are low ‘n’ markets). Yet judges are still required to make decisions about rules that are not

⁶⁸ Zywicki & Sanders, *supra* note 61, at 568.

legislative in nature. The current Posnerian law and economics method isn't able to aid judges in such cases.

The fact that the market for constitutional rules is 'low n' is not necessarily problematic. Constitutional rule-making is costly because it requires a high level of unanimity to become legitimate, and a willingness to discard the current constitutional regime would require sacrificing whatever current stability exists. Additionally, a willingness to discard a constitution and negotiate a new one might send an undesired signal to one's trading partners that one is unable to commit to long-term contracts. Thus, exchanges and agreements over constitutional rules are necessarily, and probably appropriately, 'low n.'

Without much repeated interaction, knowledge regarding the efficient constitutional constraints does not emerge, nor do mechanisms that communicate knowledge. By being 'low n,' markets for 'the rules of the game' will typically deviate from the neoclassical ideal, making the equilibrium construct a problematic tool for such questions. Without a number of repeated interactions negotiating meta-rules, or a method to transmit such knowledge, the epistemic burden on judges is quite high.

For example, many constitutional rules constrain government. These constraints exist at the constitutional level because, although there may be clear—sometimes unambiguously welfare enhancing—benefits to breaking them in the short term, the long run costs may not be worth it. However, there is no interest rate or other intertemporal coordinating mechanism, as exists in markets, for constitutional constraints. Because the epistemic burden is so high in the constitutional realm, we can often attempt to make 'efficient' (welfare maximizing) legal decisions without employing a Posnerian wealth maximization legal standard. Posner does admit

that efficiency “seems not to explain some important Constitutional rules.”⁶⁹

As Buchanan points out, traditions, precedent, and other concepts in jurisprudence do, indirectly, preserve efficiency.⁷⁰ Zywicki points out that Hayek argues in *Law Legislation and Liberty* that expectations are preserved (and thus the market’s coordinating ability) when rules are internally consistent, as opposed to externally efficient.⁷¹ Zywicki and Sanders further illustrate the high epistemic burdens the judges face under the Posnerian paradigm:

A Posnerian judge will thus face a three-fold challenge. First, the judge must possess sufficient learning, information, and expertise to be able to determine the efficient legal rule in isolation. Second, the judge must be able to determine whether the efficient rule in isolation is also the efficient rule when embedded in and interacting with *other* relevant legal rules. But finally, the judge must be able to discern how the legal rule interacts with other *non-legal* rules that may be relevant to the determination.⁷²

Without the requisite knowledge that Zywicki and Sanders describe above, questions of efficient rules in public law, constitutional law, immigration law, and international law would be a mere computational challenge. Unfortunately, the reality is that outside of repeated interaction and a mechanism for transmitting the knowledge, such knowledge does not exist and remains to be discovered.

Furthermore, efficiency considerations can only exist with respect to some end goal. When determining the constitutional

⁶⁹ Posner, *supra* note 69, at 7.

⁷⁰ Buchanan, *supra* note 1.

⁷¹ Zywicki & Sanders, *supra* note 61; Hayek, *supra* note 10, at 118-19.

⁷² Zywicki & Sanders, *supra* note 61, at 575.

rules that will govern all other social interaction, there is no contrast class or standard with which to evaluate efficiency, so equilibrium theorizing in which judges try to maximize efficiency is not useful.

IV. SPONTANEOUS ORDER THEORIZING—THE EQUILIBRIUM ALTERNATIVE

While it may be impossible to apply the neoclassical method to questions about meta-rules, this does not exclude the economic analysis of these rules. Even though such discussions tend to be dominated by, what E. Posner describes as law and economics driven by legal scholars,⁷³ economic analysis is not the consistent and persistent application of equilibrium to all social order. Economics and economists can still inform normative discussions over constitutional rules.

However, the economic tools to inform this discussion are not found in Posner. Posner's conceptualization of the economic problem precludes them. For this analysis, it is useful to understand the core economic problem as one of knowledge and view the market as an open ended spontaneous order, instead of an equilibrating mechanism.

Buchanan sees the essential value added of studying economics to be an understanding and appreciation of spontaneous order. Friedrich Hayek, possibly inspired by Bruno Leoni, sees law as a spontaneous order just like the market place. Hayek sees law as independent and the product of a larger social order. If we conceptualize law as a spontaneous order, then we don't need to rationally construct an end to use when making efficiency considerations, nor do we need to construct criteria for 'efficiency' in evaluating law; both of these things can be products of judicial action without being designed by a single person.

⁷³ Baird et al., *supra* note 44.

As opposed to the equilibrium construct, when the market exists to solve the knowledge problem, the world is in fundamental disequilibrium. In fact, the disequilibrium is what gives rise to equilibrating mechanisms like prices, profit, loss, and entrepreneurship. In this market process paradigm, efficiency is a by-product of the market process—not an end in itself, as it is in equilibrium theorizing.

By viewing the economic problem as one of dispersed and fractionalized knowledge, and the process through which order—including law—arises as spontaneous, legal concepts like precedent, tradition, and custom can take on economic meaning that a neoclassical paradigm cannot give them. Just like how prices carry knowledge that does not exist in a single person and may be beyond a human mind's ability to articulate, precedent and jurisprudential customs and traditions can do the same.

Buchanan recognizes that a complete and accurate law and economics system could not be based on a neoclassic equilibrium model. Buchanan argues that “The jurisprudential setting or framework within which his whole economic analysis of law is placed does not seem to have been critically examined” in Posner's work.⁷⁴ Instead of rationally constructing a standard, like wealth maximization, and imposing it on judges, legal doctrine should have a place in economic analysis. In Buchanan's eyes, Posner's construct forces economics onto law.

Upon further examination, we realize that law and economics requires an economics that conceptualizes the economic problem as one of knowledge and sees the solution as one that involves the spontaneous order found in the marketplace. In fact, this is the

⁷⁴ Buchanan, *supra* note 1, at 484.

foundation for Buchanan's projects in *Calculus of Consent*⁷⁵ and *The Limits of Liberty*.⁷⁶

While he is critical of the Posnerian paradigm, Buchanan is keenly aware of the limits of spontaneous order theorizing, and he is critical of the idea that such an invisible hand exists in law in the same capacity that it does in markets:

[T]he extension of the principle of spontaneous order, in its *normative* function, to the emergence of institutional structure itself. As applied to the market economy, that which emerges is defined by its very emergence to be that which is efficient. And this result implies, in its turn, a policy of nonintervention, properly so. There is no need, indeed there is no possibility, of evaluating the efficiency of observed outcomes independently of the process; there exists no external criterion that allows efficiency to be defined in objectively measurable dimensions. If this logic is extended to the structure of institutions (including law) that have emerged in some historical evolutionary process, the implication seems clear that that set which we observe necessarily embodies institutional or structural 'efficiency.'⁷⁷

However, my purpose here is not to define all spontaneous orders as inherently 'good' or 'efficient.' Despite Buchanan's criticism of Hayek here, Servant presents a convincing case for why

⁷⁵ GORDON TULLOCK & JAMES BUCHANAN, *THE CALCULUS OF CONSENT* (1962).

⁷⁶ JAMES M. BUCHANAN, *THE LIMITS OF LIBERTY* (2000).

⁷⁷ James M. Buchanan, *Cultural Evolution and Institutional Reform* (unpublished manuscript) (on file with author). See also JOHN N. GRAY, *F. A. HAYEK AND THE REBIRTH OF CLASSICAL LIBERALISM* (1982).

this criticism is not warranted.⁷⁸ My purpose here is to emphasize the importance of spontaneous order theorizing for a law and economics model that succeeds in being a fruitful tool for discussing all laws that are not pure legislation (i.e. constitutional rules and other laws that involve collective action) in light of the very restrictive, and unsuccessful, neoclassical alternative. We can rationally recognize the need for spontaneous order theorizing in law and economics.

Furthermore, Buchanan's evaluation of spontaneous order theorizing here is exaggerated on some margins. He argues, "there exists no external criterion that allows efficiency to be defined in objectively measurable dimensions."⁷⁹ This is not to say that there are not ways to approximate efficiency measures. Moreover, just because there may not be an 'objective' external criterion that we can use to evaluate a spontaneous order does not mean that no evaluation will take place. In the market for goods and services, entrepreneurs regularly perceive ways to improve that status quo. When these entrepreneurs are successful, they have effectively improved the efficiency of the spontaneous order. Spontaneous orders can certainly improve and evolve; this does not mean we cannot critique them. In fact, the 'criticism' and improvement of inefficiencies can be endogenous to the spontaneous order paradigm itself, as with the entrepreneur in a market; an analogous construct could exist in the spontaneous order of laws.

CONCLUSION

The current state of the law and economics movement and the accuracy of Buchanan's remarks in 1974⁸⁰ remind us that

⁷⁸ Regis Servat, *Spontaneous Emergence, Use of Reason and Constitutional Design: Is Hayek's Social Thought Consistent?* (June 2013) (unpublished manuscript) (on file with author).

⁷⁹ JOHN GRAY, *HAYEK ON LIBERTY* 68 (2013).

⁸⁰ Buchanan, *supra* note 1.

Buchanan's ideas are firmly part of our present.⁸¹ At the most general level, Buchanan reminds us that economics is a tool for understanding and not a tool that can be unapologetically used to promote efficiency or wealth maximization.

Buchanan wrote that "[law] is far too important to be left to lawyers," yet the current law and economics movement is one where lawyers are the only ones working on philosophical questions about what the meta-level rules should be. Meanwhile, economists are crippled by a Posnerian paradigm based on neoclassical equilibrium theorizing that only lends itself to analysis of rules within a given institutional context. In this regard, not only does Posner fail Buchanan's test, but it appears that the current law and economics profession would, too.

Buchanan's remarks are not a reason to be wary of economic imperialism. Rather we should ensure that law and economics is employing tools that will lend themselves to fruitful analysis of all areas of the law. I argue that this can be done by grounding law and economics in a view of economics that sees dispersed knowledge as the core economic problem; economic calculation as the essential function of markets; and spontaneous order as the appropriate way of theorizing about social interaction. Because of his accurate predictions, Buchanan's expanded law and economics paradigm—Constitutional Political Economy—warrants our renewed attention.

⁸¹ K. E. Boulding, *After Samuelson, Who Needs Adam Smith?*, 3 HIST. POL. ECON. 225-37 (1971).